

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6892

Petition of Central Vermont Public Service Corporation)
for approval of Security Agreement with ISO)
New England Inc. and provision of cash collateral)
thereunder)

and

Docket No. 7074

Petition of Central Vermont Public Service Corporation)
for approval to provide collateral for credit support)
under power purchase and sale agreements with)
counterparties, including purchases and sales made)
through ISO-NE, for a period not to exceed five years)

Order entered: 8/9/2010

I. INTRODUCTION

Central Vermont Public Service Corporation ("CVPS" or the "Company") filed a petition on February 22, 2010, pursuant to 30 V.S.A. § 108(a), with the Vermont Public Service Board ("Board") seeking to extend the Board's previous approvals granted in the above-referenced dockets¹ to provide collateral support for credit as may be necessary under power purchase and sale agreements with counterparties, including purchases and sales made through the Independent System Operator New England, Inc. ("ISO-NE"), for (i) a period not to exceed five (5) years from the date of the order approving this request, (ii) an indefinite period, as collateral requirements are a normal business practice in power trading transactions, or (iii) such other terms as the Board deems reasonable. CVPS notes that the previous Board approval is set to expire on October 15, 2010. The Company did not provide additional testimony in support of its

1. See Docket No. 7074, Order of 10/21/05. The two dockets were consolidated by this Order to synchronize the timing of the five-year approval periods for both dockets.

petition since the findings contained in the previous Board Order remain substantively correct except for Findings 8 and 9.² CVPS represents that the Vermont Department of Public Service ("Department") does not object to the Company's request, provided that the Board's approval is conditioned upon the following:

This Order does not constitute approval of any particular capital or operating expenditure nor the underlying capital structure that Central Vermont Public Service Corporation may implement. Nothing in this approval shall preclude the Department or any other party, or the Board, from reviewing and/or challenging those expenditures and/or the Company's resulting capital structure in any future proceeding. This Order does not constitute approval of rate recovery for any costs associated with the above activities.

On March 11, 2010, the Clerk of the Board issued a letter informing CVPS that additional financial information in the form of CVPS's audited financial statements for fiscal years 2008 and 2009 were needed in order to complete the review of the Petition.

On March 15, 2010, CVPS filed the additional financial information.

We have reviewed the Petition and accompanying documents. We conclude that approval of CVPS's Petition pursuant to 30 V.S.A. §108(a) is appropriate and that such approval may occur without hearing.

II. FINDINGS

1. Central Vermont is a company as defined by 30 V.S.A. § 201, and is subject to the jurisdiction of the Board pursuant to 30 V.S.A. § 203. Docket No. 7074, Order of 10/21/05 at 3.
2. The Company requests Board approval to provide collateral for credit support as it may be necessary under power purchase and sale agreements with counterparties, including purchases and sales made through ISO-NE, for a period not to exceed five (5) years from the date of the Order. Such collateral would include cash, letters of credit, payment bonds, third-party

2. The original calculations and formulas in Finding 8 may have changed with the passage of time, although the reasoning and issue described therein remain the same. Finding 9 has been completely revised and updated for this Order. Both findings 8 and 9 have been renumbered in this Order as Findings 7 and 8. In addition, Findings 3, 9, 22, 23, and 29 from the Board's Order of 10/21/05 were not incorporated into this Order as they are no longer applicable.

guarantees (*e.g.*, a bank guaranteeing the obligations of the Company) and other collateral, but would not include a security interest in the Mortgaged Property of the Company (essentially, all utility property) now used to secure the Company's First Mortgage Bonds. *Id.*

3. As CVPS would be providing a security interest in its corporate property (cash) or would be providing securities (letters of credit, payment bonds) as collateral, approval is required pursuant to 30 V.S.A. § 108(a). *Id.* at 4.

4. CVPS purchases and sells power through ISO-NE and also contracts with third parties to purchase or sell power. As the power market has developed and has experienced certain credit-related difficulties, parties in such contracts seek and expect protection from risk if the counterparty falls below certain credit ratings, exceeds pre-established credit limits or otherwise fails to perform under the contract. The need to provide financial assurance is becoming a requirement of all power supply arrangements. Generally, the contracts specify the provision of performance assurance in the form of cash held as collateral, a letter of credit by a third party, a payment bond, a third party guarantee or some other form of collateral acceptable to the parties. The contracts also generally provide for a parental or affiliate guarantee, but as the Company is the party in these transactions, and has no corporate parent, such a guarantee is not an available alternative. *Id.*

5. The requirement to provide performance assurance arises very quickly under the contracts; a failure of two or three business days to provide such assurance may become an event of default or limit or extinguish the Company's ability to purchase power, and such a limited time period does not afford the Company sufficient time to obtain regulatory approval to provide such collateral. Accordingly, the Company needs the ability to provide performance assurance quickly, if necessary and from time to time, and therefore seeks a more general approval of the Board to be able to provide such assurances without the need to seek specific approval at the time such assurances may be necessary. *Id.*

6. There is risk to the Company and ratepayers if the Company is unable to provide credit support. If CVPS was unable to provide the necessary credit support, its access to purchase power in the ISO market or from third parties would be severely limited or even extinguished.

Such an event would seriously jeopardize its ability to provide reliable service to its customers throughout its service territory. *Id* at 5.

7. A description of the specific Financial Assurance Policy of ISO-NE applicable to all New England Power Pool ("NEPOOL") members can be found in the Direct Testimony of Jean H. Gibson filed in Docket No. 6892, dated July 1, 2003, at 2, 3. As stated in that testimony:

Q. Please explain CVPS' obligations under the Financial Assurance Policy for NEPOOL Members.

A. CVPS purchases and sells power through ISO. CVPS has a credit limit ("CL") established with ISO, which allows CVPS to purchase and sell power up to approximately \$2.5 million of outstanding net balances without providing financial assurance. The CL, as determined by the policy, is based on a company's credit rating (by a nationally recognized rating agency) yielding a factor to be applied to the company's tangible net worth (common and preferred equity) resulting in its CL. CVPS' corporate credit rating assigned by Standard and Poor's is BBB-. Based on the policy's CL matrix, CVPS' CL is 1.2% of its tangible net worth or approximately \$2.5 million. If CVPS' credit rating were to improve to BBB+, its CL factor would increase to 2.3% resulting in a CL of approximately \$5.0 million. Conversely, if CVPS' credit rating were to fall below BBB- its CL would decrease to zero! If CVPS exceeds its CL, it must post with ISO some form of security to assure ISO that CVPS can meet its increased financial obligation. The security can be in the form of a cash deposit, a payment bond, a letter of credit, or a third-party guaranty, each of which would require approval of the Board prior to issue. The security must be provided in a ratio of \$2.60 of security for each \$1.00 of obligation (we have to post 2.6 times the outstanding net balance over our CL).

Additionally, if the Company is downgraded to below investment grade, the factor at which security must be provided increases from 2.6 times to 3.5 times. *Id.* at 5-6.

8. On December 4, 2009, Moody's Investors Service ("Moody's") assigned a Baa3 Issuer Rating for CVPS and also assigned a Baa1 senior secured rating to the Company's currently outstanding first mortgage bonds, which were previously unrated by Moody's. At the same time, Moody's affirmed CVPS's current Ba2 preferred stock rating and the Company's current stable rating outlook. CVPS's current Baa3 Issuer Rating is considered "investment grade." Petition at 2.

9. The Company provided an example contract as Exhibit JHG-1, which is a copy of the Master Power Purchase & Sale Agreement by the Edison Electric Institute and National Energy Marketers Association (the "Master Agreement"). As stated on page 5 thereof, the Master Agreement was prepared "to facilitate orderly trading in and development of wholesale power markets." Many counterparties use this Master Agreement as their power purchase and sale contract; other counterparties use separately drafted agreements which generally incorporate terms and conditions (or variants thereof) included in the Master Agreement. As such, while the Master Agreement is not necessarily used by all trading partners, it provides a reasonable and broadly accepted example of credit assurances in counterparty agreements in the U.S. power market. Docket No. 7074, Order of 10/21/05 at 6.

10. The credit provisions in the Master Agreement are in four pertinent sections. First, the "Cover Sheet," comprised of pages 1-5 of the Master Agreement, is to be completed by the counterparties to specify which particular provisions of the Master Agreement apply to the transaction, such as whether tariff provisions or acceleration of damages apply, and whether the credit and collateral provisions of only Article Eight or the Collateral Annex shall also apply. In addition, the Cover Sheet provides spaces for certain transaction-specific details, such as setting credit limits for the parties and defining whether a default on other indebtedness cross-defaults to this agreement. *Id.*

11. Second, Article Five of the Master Agreement provides Events of Default and Remedies. Section 5.1 provides normal events of default, such as failure to pay or to deliver power, and also specifies, in Section 5.1(e), failure to satisfy creditworthiness and collateral

requirements of Article Eight, to the extent such requirements have been selected on the Cover Sheet. *Id.*

12. Third, Article Eight provides different levels of credit protection. The first level is to provide financial information (Sections 8.1(a) and 8.2(a)); this presents no issue for CVPS, and does not require Board consideration. The second level of credit protection is to provide Performance Assurance within 3 days in the event of creditworthiness or performance concerns (Sections 8.1(b) and 8.2(b)) or exceeding one's credit limit (Section 8.1(c) and 8.2(c)).

"Performance Assurance" is defined in Section 1.45 of this particular contract as cash collateral, letters of credit, or other security acceptable to the party. *Id.* at 7.

13. Fourth, the Collateral Annex provides an alternative to certain sections of the credit and collateral provisions of Article Eight (Sections 8.1(c), 8.2(c) and 8.3). The Collateral Annex also requires Performance Assurance be provided (Paragraph 3), but within 1 to 2 days of notification after credit limits have been exceeded (Paragraph 4). *Id.*

14. The most important aspect of the Master Agreement, and other similar counterparty contracts, is that the collateral requirement is typically calculated as the present value of the gain or loss (contract price vs. current market price) of the expected deliveries over the life of the contract. *Id.*

15. The need to provide Performance Assurance under the Master Agreement is triggered by general and specific defined events. Sections 8.1(b) and 8.2(b) provide that if a party has "reasonable grounds to believe" that the other party's creditworthiness or performance has become "unsatisfactory," Performance Assurance may be required. Such general requirements would require a good-faith determination by the requesting party. More specifically, Sections 8.1(c) and 8.2(c) provide that if a party's net exposure to the other party exceeds the other party's credit limit (also called collateral threshold), that party may require Performance Assurance. Sections 8.1(d) and 8.2(d) provide that if a party experiences a "Downgrade Event," the other party may require Performance Assurance. A "Downgrade Event" is defined in Section 1.17, and means a downgrade by S&P or Moody's (or other identified rating agency) from the current credit rating of the party, as provided on pages 3 and 4 of the Cover Sheet. *Id.*

16. Section 8.3 of the Master Agreement specifically states that the delivery of Performance Assurance provides the receiving party with "a present and continuing security interest in, lien on . . . and assignment of, all cash and cash equivalent collateral." Paragraph 2 of the Collateral Annex specifically provides the receiving party with "a present and continuing security interest in and to, and a general first lien upon . . ." the Performance Assurance provided. It is this grant of a security interest through the provision of Performance Assurance that requires the approval of the Board before CVPS could comply. *Id.*

17. CVPS has not entered contracts which require the provision of collateral without approval of the Public Service Board. The Company has entered contracts with provisions relating to collateral. One example is an Electric Power Master Sales Agreement with a party whom Ms. Gibson identified as "Counterparty A." This Agreement contains similar provisions to the EEI Master Agreement, and CVPS enters specific transactions from time to time under this Agreement through "Confirmations." *Id.* at 8.

18. Under Section 11.1 of this Agreement, Counterparty A may request "adequate security for . . . any of its obligations . . . within two (2) Business Days . . . when the other Party has reasonable grounds for insecurity . . ." "Insecurity" is defined, for CVPS, as a downgrade of CVPS' long-term unsecured debt below BBB- or Baa3 by S&P and Fitch. CVPS can not provide such security without Board approval, and the Agreement provides that if CVPS does not provide such security, Counterparty A could declare an Event of Default and terminate the Agreement. This Agreement, however, was entered into in 1999 and precedes the more recent market instability problems experienced by numerous power market participants, and more current contracts generally contain stricter requirements. *Id.*

19. CVPS also entered into a Unit Contingent Power Supply Agreement with a party described as "Counterparty B." Under this Agreement, if the Corporate Credit Rating of CVPS is downgraded by Fitch and S&P, such that its Corporate Credit Rating is below an investment grade credit rating, then within two (2) Business Days after a request by Counterparty B, CVPS must provide cash collateral or a letter of credit. The Agreement specifically provides for a grant of a first priority security interest in, lien on and right of set off against all collateral. *Id.* at 9.

20. This Agreement provides for Board approval to allow CVPS to grant such a security interest. During negotiations, CVPS informed Counterparty B that it required Board approval before it could agree to provide such a security interest. *Id.*

21. The amount of collateral the Company might have to post is dependent on two significant factors: the Company's credit rating, and events which affect the power market. *Id.*

22. First, under the Performance Assurance Policy of ISO-NE, the Company's credit limit would be zero after such a downgrade and CVPS would be required to post collateral with ISO for all net transactions where the Company owes ISO-NE. Typically with other counterparty contracts, a non-investment grade party also has a zero credit limit, but is not immediately required to provide collateral until requested to do so by the other party. *Id.*

23. The second significant factor affecting the potential collateral requirements is events which impact the power market. In CVPS' case, the most direct events affecting the Company's power supply would be an unplanned outage of Vermont Yankee, an unanticipated extension of a planned outage, a failure by Hydro-Quebec to deliver power, or a significant increase in market power prices. A combination of these events would create additional problems. In the event the amount of power the Company had to purchase or the cost of such power significantly increased, a counterparty could determine that the resulting financial impact created financial insecurity, and could trigger the need for the Company to provide financial assurances. Additionally, these events could also cause the Company to exceed its credit limits with ISO-NE and other counterparties. *Id.* at 10.

24. In its initial petition, CVPS estimated that in the event the Company were downgraded, but no adverse power market event occurred, the present liabilities under existing contracts (including the ISO-NE Security Agreement) would translate to collateral requirements of approximately \$3,000,000 if the Company were purchasing from ISO-NE, and up to a possible \$14,000,000 if the other counterparties were to require collateral. If the Company were required to provide financial assurance in the event of the loss of either Vermont Yankee or Hydro-Quebec for a period of 30 days or more, the present liabilities under existing contracts would

translate to collateral requirements of approximately \$10,000,000 at ISO-NE, and up to a possible \$21,000,000 if the other counterparties were to require collateral. *Id.*

25. CVPS also estimated that if the Company were required to provide financial assurance in the event of a 40 percent spike in market prices, the present liabilities under existing contracts would translate to collateral requirements of approximately \$3,000,000 at ISO-NE, and up to a possible \$40,000,000, if the other counterparties were to require collateral. *Id.*

26. The Company believes that (1) the approval of the provision of cash collateral, letters of credit, payment bonds, third-party guarantees or other acceptable collateral as security in power supply transactions, (2) the maintaining of the Company's access to the power market on reasonable terms, and (3) providing for power purchase and sales flexibility, all enhance the ability of the Company to provide service to its customers and remain financially viable. Without this ability, the Company may be unable to meet its power supply needs, which would clearly be detrimental to the reliability of service to customers. Accordingly, the Company's requests are consistent with the Department's *Vermont Electric Plan*. *Id.* at 11.

27. Approval for Central Vermont to provide collateral for credit support as it may be necessary under power purchase and sale agreements with counterparties, including purchases and sales made through ISO-NE, for a period not to exceed five (5) years from the date of an order approving this request, all as described in the prefiled testimony, exhibits and subsequent filings, pursuant to 30 V.S.A. § 108(a), will be consistent with the general good of the State of Vermont as required by 30 V.S.A. § 108(a). *Id.*

III. DISCUSSION

Based upon the findings and the evidence in the record, we find that CVPS's request to extend the Board's previous approvals granted in these dockets will be consistent with the public good. We therefore grant approval of the Company's request to provide collateral support for credit as may be necessary under power purchase and sale agreements with counterparties, including purchases and sales made through ISO-NE, for a period not to exceed five (5) years from the date of this Order.

IV. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The terms and conditions proposed by Central Vermont Public Service Corporation ("CVPS") to provide collateral for credit support as it may be necessary under power purchase and sale agreements with counterparties, including purchases and sales made through the Independent System Operator New England, Inc., all as described in the prefiled testimony, exhibits and subsequent filings, pursuant to 30 V.S.A. § 108(a), will be consistent with the general good of the State of Vermont as required by 30 V.S.A. § 108(a), are approved, for a period not to exceed five (5) years from the date of this Order.

2. The terms and conditions proposed by CVPS to enter a Security Agreement and to provide cash collateral and letters of credit, payment bonds, third party guarantees and other forms of collateral as security thereunder, to allow CVPS to provide cash collateral and letters of credit, payment bonds, third-party guarantees and other forms of collateral as security, if necessary and from time to time, to satisfy the Financial Assurance Policy for New England Power Pool Members, all as described in the prefiled testimony, exhibits and subsequent filings, pursuant to 30 V.S.A. § 108, are approved, for a period not to exceed five (5) years from the date of this Order.

3. This Order does not constitute approval of any particular capital or operating expenditure nor the underlying capital structure that CVPS may implement. Nothing in this approval shall preclude the Vermont Department of Public Service or any other party, or the Board, from reviewing and/or challenging those expenditures and/or the Company's resulting capital structure in any future proceeding. This Order does not constitute approval of rate recovery for any costs associated with the above activities.

Dated at Montpelier, Vermont, this 9th day of August, 2010.

<u>s/ James Volz</u>)	
)	PUBLIC SERVICE
)	
<u>s/ David C. Coen</u>)	BOARD
)	
)	OF VERMONT
<u>s/ John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: August 9, 2010

ATTEST: s/ Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.